POST-CONFLICT ECONOMIC RECONSTRUCTION, FOREIGN DIRECT INVESTMENT AND ODIOUS DEBT

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Abstract— Foreign Direct Investment (FDI) is a key economic benefactor that promotes economic prosperity of a post-conflict nation. It is important for any nation that is resurrecting its economy during the aftermath of a conflict to accrue the benefits of FDI recognizing its potentials and capacities. This paper explores the economic aspect of conflict, the key economic indicators during conflict and the role of FDI in facilitating economic growth in such context. The study also observes the interplay between FDI and odious debts and how post economic reconstruction policies must try to avoid the detrimental aspects of FDI to ensure sustainable economic growth.

Index Terms— Conflict, Economy, Foreign Direct Investment, Odious debt

I. INTRODUCTION

It is needless to reiterate that foreign direct investment also known as FDI is more often than not the breadwinner of a developing nation. However, there comes a time when FDI itself become a problem child throwing tantrums that can echo for generations. Simply put, foreign direct investment leads to sovereign governments allowing companies incorporated in foreign countries to make large-scale investments in the hopes of effectuating substantive development in the home country. However, this hope is priced on the capacity of the home country to facilitate the FDI initiatives from beginning to the end. Therefore, in instances where FDIs fail to reach their ultimate targets it leads to one thing, debt caused by failure of the home-country to honour their side of the bargain in the investment.

Odious debt is a relatively mature concept in international law which is used to distinguish debt obtained by autocratic regimes to stuff their personal coffers as opposed to debt obtained by legitimate governments for legitimate ends. Therefore the principal objective of any post-conflict developing nation will be to navigate its foreign investment portfolio in a manner that does not lead to additional burden founded upon odious debt. It is important that wise and smart policies are put in place to marshal the investment schemes in order to avert any form of corruption or malpractice and obtain the best of what FDI has to offer in the reconstruction of a post-conflict nation.

II. ECONOMICS OF CONFLICT

The impact of war is categorized under two main principles. First being the concept of 'war renewal' [1] which propagates the idea that war in fact leads to economic, technological and social upheaval. For example the inventions from zippers to stainless steel to internet were inventions that spun from the World War II. On the contrary the 'war ruin'[1] school of thought advocates the detriments of war which is often illustrated by the great depression that occurred after the WWI that eventually led to WWII. However, for the purpose of this study, the substance in the theory of war ruins will be analysed while mapping the dynamics of a post-conflict nation.

It is evident from civil wars or political uprising and insurgencies witnessed during the past couple decades in Egypt, Sri Lanka, Colombia, Sudan etc. are fought within the territory of the country leading to a smaller peace dividend from the end of fighting. [3] This implies that unless the country adequately recovers from destruction, former civil war combatants are likely to resurrect themselves in order to secure their portion of scarce resources. As poverty persistently increases the risk of civil conflict and social unrest at mid-levels of ethnic diversity,[4] and economic development can effectively address such risks at all levels of ethnic or political diversity. Ultimately, economic recovery plays a critical role in effectively defusing militarized armed conflicts.

III. WAR AND MACROECONOMIC INDICATORS

At the very outset it should be observed that civil conflicts and squander-some regimes makes a negative impression on the national economy leading to lower GDP levels. Conflicts affect the GDP in four principal ways destroying, disrupting, diverting, and depleting national resources. [5]

Therefore the costs that arise due to the above four factors involve reconstruction of destroyed infrastructure, welfare costs and diversion of state fiscal and monetary policies to cater for defence and military oriented objectives. Through downsizing subsidies and increasing taxation, are the means through which the governments will fund its capital resource pool domestically.[6] In Sri Lanka, this had

led to a considerable portion of the GDP being fed into the military cause back in 2008-9.[7]

It is the case in many other conflict ridden nations, the diversion of the fiscal and monetary policies to feed military objectives lead to higher foreign borrowings to mitigate the budget deficits caused due to increased[8] current expenses which in turn negatively affected the foreign reserves of the country resulting *inter alia* depleting the currency and fluctuating the import export market.[9] On the other hand, increased taxation meant lack of disposable income on the part of the individual and further due to inflation caused by increased government spending led to depletion of savings.[10] Commercially speaking the lack of savings leads to the lack of resources for investment. Therefore, due to the political and economical turbulences, investment suffers as the government could no longer cater towards giving incentives for the investors. Further, the sense of instability and insecurity projects a negative image of the country which leads to the attraction of less foreign investment as seen during the course of the Sri Lankan civil war. [11]

IV. FOREIGN DIRECT INVESTMENT (FDI) AS A FACILITATOR OF GROWTH

End of civil wars or suppressive regimes are often prone to the risk of renewed conflict. Therefore it is important to implement careful post-conflict management schemes in the areas of politics, security, reconciliation and most importantly the economy. In addition to the omnipresent threat of relapse to violence, post-conflict countries are afflicted by a range of other serious risks and capacity deficits, including political instability, severe security problems and a lack of institutional and regulatory capacity. In developing countries generally and even more so in post-conflict countries, weak institutions are known to hamper entrepreneurial investments, exacerbating underdevelopment. Physical infrastructure is often damaged or unavailable, including electricity, water, transport and access to land. Corruption is often endemic, while transparency and the rule of law are either absent or extremely weak. These are all strong limiting factors on economies shattered by conflict, and deprived of skilled labour as they struggle to cope with the effects of brain drain and capital flight.

Perhaps the key reason for FDI is to be rather popular among developing nations is that investment is made possible by a foreign resident entity with limited influence from the host country's government. The host country is expected to act only within the capacity of a facilitator in terms of ensuring political stability, stable regulatory policies, access to natural resources and the like.

Accordingly, successful economic reconstruction of former civil-war affected societies rely predominantly on how fast those economies can recover from the destruction caused by conflict whether it is civil or political in nature. Since immediately usable local resources will have already been depleted during the course of conflict or divested during the tenures of illegitimate regimes, the capital investment required to rehabilitate the economy desperately needs capital transfusion in the form of foreign aid, loan and/or investment.

In this light, it is often observed that the most sustainable form of capital transfusion is in the form of foreign direct investment, since it is capable of making use of local resources whilst creating jobs for the conflict-ridden society members.

The key benefits most typically associated with FDI include first that international companies will typically have greater financial resources than their local counterparts; and second that they bring specialist expertise not only in the form of technological know-how, but also in areas such as international marketing. Third, they may be able to contribute to local transport and communications infrastructure either by the nature of their own business (as with telecommunications companies); or because they need to build roads to service their own operations (as is commonly the case with natural resources companies); or as part of a wider agreement with the government.

It is notable that many recent agreements between Chinese companies and African governments have included undertakings to develop local infrastructure such as roads and transport communications. These deals reflect the importance attached to infrastructure, although many commentators have questioned whether they are structured in a way that is truly beneficial to the host country.

There is perhaps a further other tangible benefit in that the presence of reputable international companies signals both to that the country is "open for business". For example HSBC's decision to open a bank branch in Jaffna, northern Sri Lanka, in November 2009 and Coca Cola's investment in Bosnia in 1999/2000 was widely welcomed as tangible evidence that the country was well on the path to recovery.

Thus, once peace is established, economic recovery is an issue of policy choices and governments' ability to implement them, while not aggravating the situation by its own actions. If countries exhibit different economic performance, such success or failure would result first and foremost from governments' role in the economy. Thus, the inevitable questions would be:

1. What constitute appropriate government policies for post-civil war economic recovery? and
2. How can it be known that these policies actually worked?

Generally government actions are summed up in macroeconomic stability, and the policy-induced stability will be reflected on macroeconomic statistics. [12] The importance of macroeconomic stability lies in the fact that it reduces unnecessary

uncertainty in the economy and thereby lowers the risk associated with investment. [13] If investment is suppressed due to macroeconomic instability, post-conflict economic reconstruction will be very well hampered.

The objective of economic development planners and practitioners must be to use their influence to ensure that FDI contributes to a "virtuous cycle", whereby peace building initiatives in the political arena create an environment conducive to well-designed investments, which themselves serve to reinforce the wider social foundations of peace.

Hence, encouraging a form of FDI that benefits post-conflict countries relies upon prioritizing quality of investment, rather than focusing purely on the size of investment flows. FDI can only be justified if it is high value and makes a real contribution to the host economy, in terms of job-creation and spill-over of knowledge or technology.

Crucially, any investment regime must recognize that foreign investment is part of economic development within a reconstruction and peace building process, and not an end in itself. FDI policy must balance these demands with the recognition that developing countries are competing to attract investment. Investors will naturally consider the opportunities, the legal regime and incentives available at various destinations, and decide on that basis where to invest. The investment regime is important not only for attracting new investment – it can also encourage existing investors to re-invest or to increase levels of investment. In addition, it can offer protection and privileges for Diasporas to return and assist in the economic reconstruction of their country.

V. ACQUIRING THE BENEFITS OF FDI

Accordingly, FDIs supplement the revitalization of the industries and rebuild infrastructures. Development aid alone cannot transform damaged economies into vibrant, self-sufficient systems. FDI creates job opportunities which are vital in achieving long-term economic stability. It provides capital to increase the productive capacity of the host economy, and access to international markets, helping countries to move from aid-dependent nations to investment driven post-conflict reconstruction. The presence of foreign investment can also provide a form of "peace dividend", instilling the people with a stronger sense of hope incentives to solidify the peace gained.

However, it is important to recognize that FDI can have both positive and negative impact, which must be carefully considered when designing strategic policy to attract and regulate foreign investment in post conflict context. If FDI is left to its own whim and fancy, it is unlikely to generate growth, lead to meaningful technology transfer or create the internal links necessary for development. Any potential contribution by FDI to economic growth of the host country depends upon creating links with the local economy. Attracting unsuitable or inappropriate forms of FDI risks not only forfeiting potential benefits to the host economy, but can even actively hinder development and visit negative consequences on local communities and on the environment.

The role of the government is crucial in this respect. One of the important lessons to be discerned from the success stories of the East Asian countries is the role of the *"developmental state"* in economic development. [14] The "developmental state" does not approach the development task as a dichotomized tension between the state and markets. Further it does not see any bipolarity between market-driven exports led growth and an import substitution development agenda. Rather, it calls for spearheading forces of the political sphere, various local and international economic stakeholders into a single organism with a sole national mission based on economic reconstruction. Hence what needs to be done is to project the image of an investor friendly environment [15] that goes beyond mere ground security but also the protection of investor rights. [16]

VI. FOREIGN DIRECT INVESTMENT AND ODIOUS DEBT

Odious debt is primarily founded upon both bilateral and/or multilateral loan obtained through means of sovereign finance. Sovereign finance is an umbrella term used to identify financial activities a sovereign nation engages in. In addition to loans, sale and/or lease of national assets to foreign resident entities and foreign direct investments can be identified as sources of foreign income to sovereigns. It is often observed that transactions between sovereign states and non-state commercial actors (i.e. multinational corporations etc.) which includes granting of tax concessions, property rights, profit sharing agreements do not feature in the discussion of odious debt as they do not fall within the ambit of odious debt definition since FDI does not entail public debt. [17]

However, it can be construed that FDI can be analysed from the point of odious debt doctrine on the following grounds;

a. The sovereign nation can substitute its natural resources to repayment of its debts by transferring them directly to foreign state and non-state actors;
b. Funds can be obtained through the sale of natural resources to fund the repayment of debt incurred by a government;
c. The host country has unfettered discretion in terms of regulating FDI particularly in relation to the extent of investment allowed and the degree of resources allowed to exploit. The economic activity is largely based on internal regulations which makes the leeway for any sovereign to gain an undue advantage through the investment transaction;

d. The cancellation of investment contracts entered into by the previous government, legitimate or illegitimate, being haltered, ceased or abandoned by the succeeding regime based on claims of malpractice, corruption and fraud.

In all of the above situations, the extent of which a government is involved in the investment transaction determines the possibility of such transaction eventually leading to odious debt.

Odious debt has four discerning features; [18]

1. Debt has not garnered consent of the general public
2. The funds so contracted are not spent in the best interest of the nation
3. The creditor is aware of the above factors

Similarly, it can be argued that FDI wherein it satisfies the above three elements, where an investment is allowed contrary to the consent of the general public and is not carried out in the best interest of the host country to the knowledge of the investor, can certainly amount to odious debt.

Accordingly, post-conflict economies must be vigilant in terms of signing off FDI contracts ensuring they will not lead to an odious debt. Even if at some point such arrangements are cancelled due to change of government etc. The repercussions under the *pacta sunt servanda* rule [19] which stipulate that pacts must be respected even if an oppressive dictatorship is transformed into a democracy; is it will eventually enforce the said investment contract notwithstanding the change of government [20] or the odious nature of the transaction.

CONCLUSION

FDI from a variety of different commercial sectors can be an important ingredient in recovery though FDI cannot be the universal panacea. Foreign companies are themselves influenced by wider political and economic developments, and will scarcely invest at all if the host government fails to provide a conducive environment, or if the country is still considered to be unsafe. Furthermore, the impact of individual investments will depend on the extent to which they are managed in a conflict-sensitive manner.

Thus, identifying the best practices that would market the country as a sound and viable foreign investment ground and placing a stringent legal and regulation policies to minimize the potential harms of such measures that leads to odious debts and other detrimental ends, would be the apt paradigm shift any post-conflict government can initiate to foster the economic reconstruction of a post-conflict nation.

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[7] *Ibid.*, p. 133

[8] For example current account deficit in 2008 increased from previous year's Rs.-154,717Mn to Rs.-420,042Mn; *Ibid.*, p. 126 – 129

[9] Total amount of external assets decreased by 2% in 2006 compared to 2005; *Ibid*., p. 117; while reserve money dropping from 10.2% in 2006 to 1.5% in 2008; *Ibid*., p. 97

[10] The percentage of public and private savings were -2.8% of the GDP in 2008; *Ibid.*, p. 5, 53 – 54

[11] *Ibid.*, p. 52

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[15] This would also involve addressing other prevalent issues such as establishing non discriminatory screening, business friendly entry and post entry regulations would cater for growing FDI influx as well.

[16] For example the case of *Mihaly International Corporation* v. *Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/00/2 (March 15, 2002)

[17] Y. Wong *Sovereign Finance and Poverty of Nations: Odious debt in International Law* (Edward Elgar, 2012) p.30-31

[18] A. Khalfan, J. King and B, Thomas, *Advancing the Odious Debt Doctrine* (Toronto: Centre for Institutional Sustainable Development Law, 2003) p.14

[19] The above rule is based on the award of *Company Z v State Organisation ABC* (1983) 8.Y.C.A. 94

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